



CDFI ORGANIZATIONAL STRUCTURES

This section describes the organizational structures and characteristics of CDFIs. It provides information that can assist financial institutions and community leaders in identifying and evaluating partnership opportunities.

There are four types of CDFIs: banks and bank holding companies, credit unions, loan funds, and venture capital funds. CDFI banks, bank holding companies, and credit unions are depository institutions regulated by federal and state agencies. CDFI loan funds and venture capital funds are not federally insured financial institutions and therefore are not subject to oversight by the federal banking regulators. Each of the four types of CDFIs has a different legal structure and unique investment opportunities, and provides a different mix of financial products and services to reach specific customers in low-income communities.

As of March 31, 2014, there were 831 certified CDFIs: 84 community development banks, 51 depository institution holding companies, 190 credit unions, 493 loan funds, and 13 venture capital funds¹². CDFI certification is a designation conferred by the CDFI Fund.

CDFI certification is formal acknowledgement from the CDFI Fund that a financial institution meets certain community development finance criteria. To become certified, a financial institution must apply to the CDFI Fund and meet the following criteria:

- Have a primary mission of community development;
- Be a financing entity;
- Serve one or more target markets;
- Provide development services to borrowers in conjunction with financing activities;
- Maintain accountability to a target market; and
- Be a nongovernmental entity.¹³

Certification by the CDFI Fund is not an indication of a CDFI's financial performance or soundness, or a measure of its effectiveness in achieving its mission. Many community development lenders provide financial and technical assistance services but do not meet the CDFI Fund's criteria or have chosen not to pursue certification.

The information in this guide is applicable to both CDFIs that have received certification under the U.S. Department of the Treasury program and those that have not. Implications for an institution's CRA evaluation may exist, depending on the certification status of a CDFI partner. These considerations are considered in Section V of this guide.

12 U.S. Department of the Treasury CDFI Fund, "Community Development Financial Institution Fund – List of Certified Community Development Financial Institutions (CDFIs) with Contact Information as of March 31, 2014. Available at http://www.cdfifund.gov/what_we_dolprograms_id.asp?programID=9.

13 Riegle Community Development and Regulatory Improvement Act of 1994, Public Law 103-325, 108 Stat. 2160 (1994). Available at <http://www.gpo.gov/fdsys/pkg/BILLS-103hr3474enr/pdf/BILLS-103hr3474enr.pdf>.

A. CDFI Banks

1. Key Characteristics

CDFI banks are federally insured and regulated depository institutions with a primary mission of community development. These FDIC-insured banks are organized like traditional banks and offer a wide range of banking services. What distinguishes CDFI banks from other financial institutions is their community development mission and the requirement that at least 60 percent of their financing activities be targeted to one or more low- and moderate-income or underserved communities.¹⁴

Of the 84 CDFI banks, approximately 50 percent are Minority Depository Institutions (MDIs). The FDIC publishes on a quarterly basis a list of MDI banks at www.fdic.gov/mdi. The list includes FDIC-supervised banks that meet either of the following two definitions: federally insured depository institutions in which (1) 51 percent or more of the voting stock is owned by minority individuals, or (2) the majority of the board of directors is minority and the community that the institution serves is predominantly minority.¹⁵ The FDIC's list of MDI banks also includes FDIC-insured minority depository institutions that are supervised by the Office of the Comptroller of the Currency (OCC) and the Federal Reserve. Each of those agencies has its own definition of MDIs. FDIC publishes the names of MDIs supervised by the OCC and Federal Reserve that are consistent with the MDI categories defined by Section 308 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989.¹⁶ Participating in the MDI program is voluntary and some institutions meeting the above definitions choose not to be included on the list.

2. Borrowers

Borrowers of CDFI banks include individuals, businesses of all sizes, nonprofit community organizations, and real estate developers.

3. Ownership

CDFI banks are for-profit corporations with a community and economic development mission and community representation on their board of directors or advisory board.

4. Regulation

Depending on their individual charter, the primary federal regulator for CDFI banks is the FDIC, the Federal Reserve, or the OCC. State-chartered institutions are also regulated by state banking agencies. Deposits in these institutions are insured by the FDIC up to the maximum amount allowed by law.

5. Lending and Investment Opportunities

The most common type of investment that banks make in CDFI banks are loans, which the CDFI bank in turn uses to make loans directly to low- and moderate-income borrowers. These may be structured as lines of credit or term loans.

14 Khanh Vuong and Dianne Goodheart, "Rating U.S. CDFI Banking Organizations," A.M. Best Company (January 8, 2009). Available at <http://www.ambest.com/ratings/methodology/RatingUSBankingOrgs.pdf>.

15 Federal Deposit Insurance Corporation, Policy Statement Regarding Minority Depository Institutions, April 9, 2002. Available at <http://www.fdic.gov/regulations/resources/minoritypolicy.html>.

16 Federal Deposit Insurance Corporation, Policy Statement Regarding Minority Depository Institutions. Federal Register Vol. 67, no. 73 (April 16, 2002), 18618. Available at. <http://www.fdic.gov/regulations/laws/federal/02sopMINOR.pdf>.

Banks also can participate in loans with CDFI banks in a safe and sound manner.¹⁷ Loan participations can help traditional banks diversify their lending portfolios and manage risk. Loan participations can help CDFI banks originate larger loans while remaining within their legal lending limits. They can also help CDFI banks keep customers who may need a broader range of services.

Under some circumstances, banks may be permitted to buy the stock of CDFI banks, but they must be mindful of any legal and regulatory constraints including, but not limited to, Section 3 of the Bank Holding Company Act. Banks can also deposit funds in CDFI banks, which would be insured by the FDIC up to the maximum allowed by law.

B. CDFI Credit Unions

1. Key Characteristics

CDFI credit unions are federally insured financial cooperatives that are designed to provide financial services to individuals who are members of the credit union. The National Credit Union Administration (NCUA, an independent federal agency) charters, supervises, and insures federal credit unions, and insures the majority of state-chartered credit unions. The deposits in these institutions are insured by NCUA up to the maximum allowed by law.

The majority of CDFI credit unions have sought and received designation as “low-income” credit unions by NCUA.¹⁸ This designation allows these institutions to accept nonmember deposits and secondary capital, which is an uninsured, fully subordinated debt instrument that enhances a credit union’s net worth.¹⁹ The low-income designation means that more than half of a credit union’s membership earns 80 percent or less than the median family income for the metropolitan area where they live or the national median family income for all metropolitan areas, whichever is greater. For members living outside a metropolitan area, low-income members are those who earn 80 percent or less than the median family income for the statewide or national nonmetropolitan area, whichever is greater.²⁰

2. Borrowers

CDFI credit union borrowers are members of the credit union. Depending on their charter, some CDFI credit unions may grant loans to businesses as well.

3. Ownership

CDFI credit unions are owned by members of the credit union through shares of the cooperative. The policies of credit unions are governed by a board of directors that is elected by and accountable to the membership.

17 FDIC Advisory on Effective Credit Risk Management Practices for Purchased Loan Participations, FDIC FIL-38-2012, September 12, 2012. Available at <http://www.fdic.gov/news/news/financial/2012/fil12038.html>.

18 National Credit Union Administration, Designation of Low-Income Status; Acceptance of Secondary Capital Accounts by Low-Income Designated Credit Unions – Final Rule. Federal Register Vol. 78, No. 13 (January 18, 2013). Available at <https://www.federalregister.gov/articles/2013/01/18/2013-00859/designation-of-low-income-status-acceptance-of-secondary-capital-accounts-by-low-income-designated>.

19 As permitted under state and federal law or regulation.

20 National Credit Union Administration, “The Low-Income Designation,” Federal Register Vol. 75, no. 246 (December 23, 2010), 80677. Available at www.ncua.gov/Legal/Documents/Regulations/FIR20101216LowIncome.pdf.

4. Regulation

Federal credit unions are regulated by NCUA, and state-chartered credit unions are regulated by state agencies.

5. Lending and Investment Opportunities

Banks can make nonmember deposits to CDFI credit unions. Deposits are insured by the NCUA up to the maximum allowed by law. Banks can also provide donations, grants, and secondary capital, which would be considered investments for the bank under the CRA.

Banks can provide or participate in loans to CDFI credit unions, which would receive consideration under the lending test for CRA.

Banks can invest indirectly in CDFI credit unions through the National Federation of Community Development Credit Unions, which then passes the funds on to a credit union in the bank's geographic area. Additional information on this intermediary is provided in Section IV.C. of this guide.

C. CDFI Loan Funds

1. Key Characteristics

CDFI loan funds, which represent the largest percentage of CDFIs, are nondepository financial institutions that are generally not subject to federal banking regulations. Their borrowers are small businesses, nonprofit organizations, charter schools, individuals, and organizations involved in affordable housing and community development, including healthy food financing initiatives.

CDFI loan funds often have more flexible lending policies than regulated CDFI banks and traditional banks. Because CDFI loan funds manage risk in a variety of ways—for example, by providing multiple layers of financing, guarantees, matched funds, peer lending, pooled risk, borrower education, and ongoing technical assistance—they can finance development projects more easily than many other lenders. CDFI loan funds provide intensive financial education and counseling to individual and business borrowers.

CDFI loan funds lend independently, with other nonprofit partners, and in partnership with traditional and CDFI banks, which provides traditional banks the opportunity to participate in loans that may not meet their underwriting requirements. CDFI loan funds may also take a subordinate position when lending in partnership with traditional banks.

Almost all CDFI loan funds are organized as nonprofit organizations. Nonprofit CDFI loan funds can raise equity from government funding, social investments, and philanthropies.

2. Borrowers

CDFI loan funds often specialize in financing certain types of borrowers: housing (affordable housing developers), business, microenterprise (very small businesses), and community service organizations (nonprofits).

3. Ownership

Most CDFI loan funds are structured as nonprofit organizations.

4. Regulation

CDFI loan funds are subject to the state laws in which they operate. Almost all CDFI loan funds obtain independent third-party audits conducted by certified public accountants; follow

General Accepted Accounting Principles (GAAP); and operate under agreed-upon financial covenants by various funding sources, such as philanthropic funds, that impose operational safeguards and guidance.

5. Lending and Investment Opportunities

As permitted by law and regulation, banks can provide equity to CDFI loan funds through grants. Banks may provide equity-equivalent investments, which are subordinated debt instruments with features such as rolling terms and limited right-to-accelerate payments that enable them to function in a manner similar to equity. Banks also can provide conventional loans directly to CDFI loan funds.

Banks can structure loans to provide financing in conjunction with a CDFI loan fund. For example, a bank can make a loan that is senior to CDFI subordinated debt. Such financing structures may reduce costs and increase access to credit for bank borrowers who fit the CDFI lending parameters. Even without subordination, the bank can co-lend and limit exposure to the risk of a larger loan, while the customer benefits from additional financing. Banks can participate in the loans originated by the CDFI loan funds and buy seasoned CDFI loans.

D. CDFI Venture Capital Funds

1. Key Characteristics

CDFI venture capital funds make equity investments, equity-like investments, and below-market loans to businesses in underinvested markets, and to companies, in any location, that will provide jobs and training opportunities to low- and moderate-income people. The businesses targeted for investment by CDFI venture capital funds have the potential to create quality jobs, wealth, and entrepreneurial capacity for low-income people. The funds invest in companies in different industries and stages of development. Unlike traditional venture capital funds, which have a primary objective of financial returns for their investors, community development venture capital funds promote social and financial returns.²¹

CDFI venture capital funds provide intensive managerial and entrepreneurial assistance to the businesses in which they invest. This technical assistance has often proven to be just as important as the financing support to the companies in which a venture capital fund invests.

CDFI venture capital funds typically take seats or observer rights on the boards of their portfolio companies. Some CDFI venture capital funds become part-owners of the companies in which they invest. Others use warrants, success fees, royalty arrangements, participation agreements, and similar financial incentives to secure their influence over the owners.²²

A CDFI venture capital fund typically has a 10- to 13-year lifespan.²³

2. Borrowers

Recipients of CDFI venture capital funds are for-profit, small, and medium-sized businesses in markets that typically do not attract traditional venture capital, and have the potential for

21 Community Development Venture Capital Alliance, "CDVC Funds." Available at http://www.cdvc.org/index.php?option=com_content&view=article&id=52&Itemid=58.

22 Community Investments, "Venture Capital for Communities" (Federal Reserve Board of San Francisco: March 2002), p. 24. Available at http://www.frbsf.org/community-development/files/community_investments_March_2002.pdf.

23 Financial Strategies and Research, Three-Year Trend Analysis of CDFI Awardee Report Data: 2006-2008, CDFIs Reporting Data to the Community Investment Impact System (CIIS). (Washington DC: U.S. Department of the Treasury CDFI Fund, October 2010).

rapid growth, market-rate financial returns, and the creation of good jobs, community wealth, and entrepreneurial capacity.²⁴

3. Ownership

CDFI venture capital funds can be organized as for-profit or nonprofit entities. Most for-profit CDFI venture capital funds are organized as limited partnerships or limited liability companies. Of the 13 CDFI Fund-certified venture capital funds, 4 are organized as for-profit institutions and 9 as nonprofits.²⁵

4. Regulation

CDFI venture capital funds are not subject to federal banking regulations. However, they are subject to state securities regulations and Securities and Exchange Commission reporting requirements for disclosures to investors.

5. Lending and Investment Opportunities

An investor in a qualifying for-profit CDFI venture capital fund can buy stock in a corporation or the interests in a limited partnership or limited liability company, as permitted by law and regulation. Capital is invested in the form of equity, and the investor's return on investment depends on the success of the fund's underlying investment in the businesses.²⁶

In qualifying nonprofit CDFI venture capital funds, bank investors can provide grants, equity equivalent investments, and conventional loans as permitted by law and regulation and in accordance with safety and soundness standards.²⁷

24 Community Development Venture Capital Alliance, "CDVC Funds."

25 U.S. Department of the Treasury CDFI Fund, "Community Development Financial Institution Fund – List of Certified Community Development Financial Institutions (CDFIs) with Contact Information as of March 31, 2014.

26 Center for Community Development Investments, "Community Development Venture Capital," CRA Investment Handbook (Federal Reserve Bank of San Francisco: March 2010), pp. 24-26. Available at <http://www.frbsf.org/community-development/files/CRAHandbook.pdf>.

27 The investment would have to be permissible as a public welfare investment as defined in 12 U.S.C. Section 24(Eleventh) (or otherwise permissible for a national bank), a qualified investment for CRA purposes, an investment in qualified housing projects as defined in the FDIC's regulations at 12 CFR § 362.3(a)(2)(ii), or deemed permissible following application to the FDIC and a finding by the FDIC that the state bank met (and continued to meet) applicable capital standards and that the proposed investment would pose no significant risk to the deposit insurance fund. Interests in a limited partnership or LLC would be evaluated by the FDIC to ensure that the bank would not subject itself to unlimited liability and that the organizational documents satisfied applicable state law.